SUPREME COURT, U. S.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 73-1701

UNITED STATES OF AMERICA, APPELLANT

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., *et al*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

BRIEF FOR APPELLEES WELLINGTON MANAGEMENT COMPANY AND WELLINGTON FUND, INC.

ROBERT E. JENSEN
Williams & Jensen, P.C.
1130 17th St. N.W.
Washington, D.C. 20036

RICHARD M. PHILLIPS
ROBERT A. WITTIE
Hill, Christopher & Phillips, P.C.
2000 L St. N.W.
Washington, D.C. 20036
Attorneys for Appellees Wellington Management Company and Wellington Fund, Inc.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

PAGE

OURT CASES

PAGE

LEGISLATIVE HISTORY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 73-1701

UNITED STATES OF AMERICA, APPELLANT

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., *et al*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

BRIEF OF APPELLEES WELLINGTON MANAGEMENT COMPANY AND WELLINGTON FUND, INC.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq.*, ("Investment Company Act") are set forth in the Statutory Appendix hereto.

QUESTIONS PRESENTED

1. Was the District Court correct in ruling that the "pervasive regulatory scheme of § 22 of the Investment Company Act" pre-empted the antitrust laws and gave the SEC exclusive jurisdiction in the "narrow area of distribution and sale of mutual fund shares"?

2. Was the District Court correct in ruling that the retail price maintenance provisions of § 22(d) and its "necessary companion," § 22(f), authorizing restrictions on transferability

of mutual fund shares, specifically exempt the alleged unlawful activities from normal antitrust strictures?

COUNTER STATEMENT OF THE CASE

The Antitrust Division of the Department of Justice ("Appellant") seeks in this direct appeal to overturn the decision of the District Court for the District of Columbia, dismissing with prejudice an action instituted pursuant to § 4 of the Sherman Act, 15 U.S.C. § 4. Wellington Fund, Inc. ("Wellington Fund") and Wellington Management Company ("Wellington") are Defendant-Appellees herein and submit this brief in support of the District Court's decision.

Wellington Fund is an open-end investment company, commonly called a "mutual fund," and is regulated by the Securities and Exchange Commission under the Investment Company Act. Wellington is the principal underwriter of shares issued by Wellington Fund. Wellington is regulated by the SEC as a broker-dealer under the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78a, *et seq.*, ("Exchange Act") and as an investment adviser under the Investment Advisers Act of 1940, as amended, 15 U.S.C. § 80b-1, *et seq.*

The other Defendant-Appellees include seven securities dealers which sell mutual fund shares to the investing public and the National Association of Securities Dealers, Inc., ("NASD"). The NASD is the only national securities association registered with the SEC under the "Maloney Act" (§ 15A of the Exchange Act, 15 U.S.C. § 78*o*-3). The NASD, subject to SEC oversight, exercises industry self-regulatory functions with respect to the distribution of mutual fund shares and other transactions in the over-the-counter securities markets. Wellington, as well as all brokers and dealers registered under the Exchange Act, is required by § 15(b)(8) of that Act, 15 U.S.C. § 78*o*(b)(8), to be either a member of the NASD or to submit to equivalent regulation directly by the SEC.

THE COMPLAINT

The Complaint[1] alleged that the Appellees, in violation of § 1 of the Sherman Act, entered into a conspiracy in restraint of trade, designed to prevent the development of a "secondary dealer market" and a "brokerage market" in the purchase and sale of mutual fund shares. The Complaint specifically alleged that various rules of the NASD, as well as other NASD activities, constituted an integral part of the alleged conspiracy.

Appellant now states that it "is not challenging the validity of the NASD rules themselves" (App. Br. at 51, n. 47). Hence, apart from the horizontal allegations of Count I, Appellant has left only the allegations of the Complaint which relate to certain contracts among principal underwriters, mutual funds and broker-dealers ("sales agreements"). The sales agreements allegedly contain provisions which, *inter alia,* obligate the principal underwriters and retail dealers in fund shares either to act as principals or, if acting as agents, to maintain the public offering price described in the funds' prospectuses. They allegedly also prohibit retail dealers from (1) buying shares for resale to customers from persons other than the funds or the principal underwriters; and from (2) selling shares purchased from customers to persons other than the funds or their principal underwriters (Compl. Counts II-VIII).

The Complaint was filed after institution of a private treble damage class action, based upon substantially similar allegations, against many of the same defendants (*Haddad* v. *Crosby Corp.,*

---

[1]References to "the Complaint" or "Compl." are to Appellant's Complaint filed in the District Court for the District of Columbia in Civil Action No. 338-73; references to "App. Br." are to Appellant's Brief on the Merits submitted to this Court; references to "J.S." are to Appellant's Jurisdictional Statement. References to "J.S. App." refer to the opinion of the District Court as printed in the Appendix to the Jurisdictional Statement. References to "Joint Appendix" are to the Joint Appendix filed by Appellant and Appellees in this case. Except where otherwise noted, emphasis in quotations has been supplied throughout this Brief.

Civ. No. 2454-72 (D.D.C. December 8, 1972)). Subsequent to the filing of the Complaint, forty-two additional private treble damage class actions were filed. The Judicial Panel on Multidistrict Litigation ordered all of the private class actions transferred to and consolidated in the District Court for the District of Columbia.

THE DISTRIBUTION OF MUTUAL FUND SHARES

The Complaint attacks the activities of Appellees in the distribution of mutual fund shares. The system for such distribution reflects the unique characteristics of mutual funds which continuously offer their shares for sale to the public and which, as required by law, allow investors continuously to redeem fund shares at net asset value. Depending on the mutual fund involved, a sales charge or "load" may be imposed by the fund on sales of its shares.

The unique characteristics of mutual funds have been recognized by this Court in *United States* v. *Cartwright*, 411 U.S. 546 (1973). The Court there observed:

> "Unquestionably, the most unique characteristic of mutual funds is that they are permitted, under the [Investment Company] Act to market their shares continuously to the public, but are required to be prepared to redeem outstanding shares at any time. § 80a-22(e)." 411 U.S. at 547.

The continuous obligation of redemption and the offering of fund shares are closely interrelated. Since mutual funds must continuously redeem outstanding shares, they can avoid self-liquidation only if they can continuously offer new shares. This interdependence was recognized by the District Court:

> "To insure that the fund has sufficient cash or liquid assets on hand to meet current redemptions, the fund offers its common stock continuously. . . . The viability

> of a fund thus depends upon a distribution system which will effect continuous sales at prices which will support current redemption demands." J.S. App. at 42, 43.

To sell continuously to the public, mutual funds, such as Wellington Fund, typically enter into exclusive distribution contracts with underwriters, such as Wellington. The underwriters in turn establish continuous distribution channels by entering into agreements with numerous securities dealers. The dealers then sell the funds' shares to the public and accept them from the public for redemption by the funds. Most dealers enter into sales agreements with many principal underwriters and sell shares of many different funds to the public. This is the primary distribution system. As recognized by this Court in *Cartwright,* for all practical purposes it is the "only market" for mutual fund shares. 411 U.S. at 551.

REGULATION OF THE DISTRIBUTION SYSTEM

The Investment Company Act also recognized the importance of continuous redemption and distribution and established elaborate regulatory mechanisms governing both of these unique characteristics of mutual funds. Thus, § 22(e) of the Act expressly codifies and subjects to SEC regulation the right of mutual fund shareholders to redeem fund shares on demand. It prohibits a mutual fund from suspending the right of redemption, or from postponing payment upon redemption, during unrestricted trading periods on the New York Stock Exchange, for more than seven days after tender, except under very limited conditions as determined by the SEC.

The Act also regulates the primary distribution system, including the relationships between principal underwriters and investment companies in that system. Section 12(b) expresses a preference that load mutual funds distribute their shares through principal underwriters. Sections 15(b) and (c) require

the principal underwriter to act for the fund pursuant to a written contract. The contract must contain specific provisions prescribed by the Act. It must also be approved by the fund's shareholders or by the fund's board of directors which must meet the criteria for independence contained in § 10(b)(2) of the Act.

The provisions of the Act also reflect a Congressional determination to protect the primary distribution system from secondary market competition. As the Commission reported in 1972:

> "Elimination of that market was considered to be a major motivation behind the enactment of Section 22(d)."[2]

Section 22(d) accomplishes this objective by imposing what Appellant has characterized as a "rigid scheme of price maintenance at the retail level."[3] It expressly requires that:

> "if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus."

Section 22(d) is not limited to the primary distribution system. It requires all "dealers", whether they operate in the primary system under contract with the principal underwriter or in the secondary market, to sell mutual fund shares at the price fixed

---

[2] *Report of the Staff of the SEC on the Potential Economic Impact of a Repeal of § 22(d) of the Investment Company Act of 1940,* November, 1972, Pt. II, at 292. (Hereinafter referred to as "1972 SEC Staff § 22(d) Report").

[3] *Comments of the Department of Justice Before the SEC Mutual Fund Distribution Hearings,* SEC File No. 4-164, Feb. 2, 1973 at 3.

in the prospectus. As stated by former SEC Chairman Manuel F. Cohen in testimony before Congress:

> "The statute is unequivocal. No person, no matter where he got it, from the issuer, from another dealer, or even from a private person, no broker-dealer may sell a share of a particular fund at a price less than that fixed by the issuer."[4]

In § 22(f) of the Act, Congress preserved for mutual funds an additional means of protection against the secondary market. That section recognized the right of mutual funds, subject to disclosure and SEC regulation, to impose restrictions on the transferability of their shares. Such restrictions, prior to enactment of the Investment Company Act, had been used by the funds to protect the primary distribution system against the secondary market by issuing certificates which provided "substantially that the shares could only be sold or tendered for redemption to the open-end investment company."[5]

Sections 22(d) and 22(f) have substantially achieved their purpose. The Commission has estimated that in the pre-1940 mutual fund industry the secondary market dollar volume of shares sold was equal to the volume of sales through the primary distribution system. (Investment Trust Study at 809). In contrast, as the SEC has found, secondary market volume in 1971 was "miniscule". (1972 SEC Staff § 22(d) Report at A-113).[6]

---

[4]*Hearings on H. R. 9510 and H. R. 9511 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce,* 90th Cong., 1st Sess. 711 (1967). (Hereinafter referred to as "1967 House Hearings").

[5]*SEC Report on the Study of Investment Trusts and Investment Companies,* Pt. Three, House Doc. No. 279, 76th Cong., 1st Sess. 865 (1939-40). (Hereinafter referred to as "Investment Trust Study").

[6]The secondary market in mutual fund shares both before and after 1940 was a dealer market. Appellant has not claimed that there ever was a brokerage market in fund shares as described in its Complaint.

Congress balanced its proscription against retail price competition with regulatory protections against "excessive" sales charges and unfair dilution of investor interests. Section 22(a) of the Act empowers the NASD to adopt rules prescribing methods for computing minimum sales and redemption prices designed to reduce and, insofar as possible, to eliminate unfair dilution of the interests of fund shareholders. Section 22(b), as amended in 1970, not only authorizes but directs the NASD, under SEC oversight, to prescribe rules prohibiting "excessive" sales charges.[7] Pursuant to this Congressional directive, the Commission recently allowed the NASD to adopt proposed rules setting sales load limits on mutual fund shares.[8]

THE DECISION BELOW

In dismissing Appellant's Complaint, the District Court emphasized the critical importance of the primary distribution system and the policy of Congress to reject "all attempts to foster a secondary market which might operate to the detriment of the primary market." (J.S. App. at 47). After reviewing the legislative history and the SEC's interpretation of § 22(d) and § 22(f), the court held that each of those sections specifically exempted Appellees' sales agreements from the antitrust laws. The court said:

> "It is thus apparent that Congress designed §§ 22(d) and 22(f) to create and protect a primary distribution system which is repugnant to the antitrust laws and did so in complete recognition of the fact that the legislation would frustrate the growth of a free secondary market. That statutory scheme is 'incompatible with the maintenance of (an) antitrust action.'" J.S. App. at 58 (Citations omitted).

[7]Prior to the 1970 amendments, § 22(b) authorized the NASD to adopt rules prohibiting "grossly excessive" sales charges.

[8]Investment Company Act Release No. 8570 (Nov. 4, 1974), CCH Fed. Sec. L. Rep. ¶ 79,998 (1974).

The District Court went on to rule that, even if no specific exemptions existed, the pervasive system of regulation of the distribution of mutual fund shares imposed by the Investment Company Act and the Maloney Act placed responsibility for regulating "this complex field" within the exclusive jurisdiction of the SEC. The court stated:

> "The language of both acts clearly defines the pervasive statutory and administrative control over the area and manifests a congressional intent to leave this complex field to the supervision and control of an expert administrative agency." *Id.* at 62, 63.

Accordingly, the court ruled that the two acts gave rise to a "narrow," implied exemption from the antitrust laws. The court held:

> "[G]iven the fact that Congress clearly intended to substitute a pervasive regulatory scheme, i.e. § 22 of the [Investment Company] Act, for the usual antitrust prohibitions in the narrow area of distribution and sale of mutual fund shares, it is clear that the price maintenance practices complained of are immune from ordinary antitrust strictures." *Id.* at 67.

In so ruling the court below found that "[s]ince 1940, the SEC has actively regulated the pricing and distribution of mutual fund shares" (*Id.* at 39), that § 22(d) "has been reconsidered by Congress several times", and that despite the urging of Appellant, Congress has "consistently refused to modify or repeal it. . . ." (*Id.* at 51). The court pointed out:

> "Whether the mutual fund marketing structure mandated by Congress in 1940 should be eliminated or modified is an issue for Congress and the SEC, not the Judicial Branch, to hear and to decide. In fact, in urging its complaint upon the Court, one of the plaintiffs, *viz.*, the

Department of Justice, seeks to accomplish indirectly what it has failed, so far, to achieve directly—the repeal or modification of § 22(d)—in hearings before both Congress and the SEC." *Id.* at 58.[9]

THE 1974 SEC § 22(d) REPORT

On November 4, 1974, SEC Chairman Garrett transmitted to Congress a report on "Mutual Fund Distribution and Section 22(d) of the Investment Company Act of 1940." ("1974 SEC § 22(d) Report" or "Report").[10] At the same time, the Commission announced its program to revise its administration of, and to seek legislative changes in the laws affecting, mutual fund distribution.[11]

The Commission's program constitutes a multifaceted plan for a gradual restructuring of the mutual fund distribution system. Some restructuring was found desirable by the Commission because of the "new and serious difficulties" which now beset the mutual fund industry. (Transmittal Letter at iii). The Commission noted that "the operation of the regulatory system" restricted the ability of the industry to adjust to changed conditions and that:

> "Meanwhile, changes in brokerage allocation practices of mutual funds, the reduction in mutual fund brokerage resulting from the onset of fully competitive stock exchange rates, and competition from other financial products which can be more easily sold on the basis of current yield (and which also offer attractive incentives to salesmen); make it increasingly difficult for mutual funds to

---

[9]See, e.g., *1967 House Hearings;* and *Comments of the Department of Justice Before the SEC Mutual Fund Distribution Hearings, supra,* n. 3.

[10]CCH Mutual Funds Guide, (Part II) Nov. 8, 1974. References to the Report itself are cited as "1974 SEC § 22(d) Report at "; references to Chairman Garrett's letter transmitting the 1974 SEC § 22(d) Report to Congress are cited as "Transmittal Letter at ."

[11]Investment Company Act Rel. No. 8570 (Nov. 4, 1974), CCH Fed. Sec. Rep. ¶ 79,998.

> compete successfully for the salesman's favor, even while they are hampered in developing market demand among investors." *Id.* at iv.

In light of these changed conditions, the Commission's program is designed to:

> "[L]ay the groundwork for the gradual and orderly introduction of retail price competition into the mutual fund distribution system." *Id.* at v.

The SEC's program, when implemented, would effect many of Appellant's desired changes in mutual fund distribution. Indeed, the Report specifically concluded that the sales agreements which are the subject of this case should be modified—either voluntarily or by a rule promulgated pursuant to § 22(f)—to allow the establishment of a "limited secondary brokered market" in mutual fund shares. However, contrary to the result being sought by the Appellant, the Report does not recommend the immediate elimination of restraints on a secondary dealer market. Rather, the Report states that the operation of the "brokered" market would provide the SEC with "important insight into whether a secondary *dealer* market could function effectively." (1974 SEC § 22(d) Report at 105) [Emphasis in the original].

The development of the brokered market recommended by the Report would occur "in the context of the Commission's total regulatory scheme respecting fund distribution." The Commission recognized that development of a secondary brokerage market requires other regulatory changes "designed to encourage economies and efficiencies in the present fund distribution system and ultimately to move the industry into a position where it could function effectively in an environment of full retail price competition." Such changes include, but are not limited to, liberalization of mutual fund advertising rules,[12] expanded group

[12]1974 SEC § 22(d) Report at 84.

sales[13] and so-called "open seasons."[14] These changes, moreover, will be conditioned by provisions designed "to help neutralize any adverse impact upon the funds' primary distribution system. . . ." The conditions include:

Transfer Fees For Brokered Transactions[15]

To ensure that the underwriter is adequately compensated for its advertising and distribution efforts, the Commission will allow a reasonable transfer fee on brokered transactions. Such a fee would be collected by the fund when ownership of its shares is transferred and would, of course, aid in protecting the primary distribution system and ensuring that the fair allocation of continuing costs are borne by all fund shareholders.

Anti-Warehousing Provisions[16]

The Commission also proposed to prohibit brokered orders from being held for more than one full business day, thereby preventing excessive delay in execution of customers' orders.

Special Exemptive Orders[17]

The Commission made it clear that whenever a fund demonstrates that its primary distribution system is being injured by the secondary brokered market, it will consider issuance of an exemptive order under § 22(f) to allow reimposition of the contractual restrictions complained of by Appellant.

---

[13] *Id.* at 89.
[14] *Id.* at 93, 94.
[15] *Id.* at 105, 106.
[16] *Id.* at 107.
[17] *Id.* at 108.

All of these changes, those designed to encourage competition, those designed to protect the primary distribution system, and those otherwise designed to protect investors, were proposed in light of the Commission's understanding of that system and of the drastic consequences of its forced and sudden abandonment. As the Commission concluded:

> "[I]t would be unrealistic to suppose that a sudden end to retail price maintenance would be accompanied by the level of investor sophistication and sensitivity to sales loads that would be needed to make a price competitive distribution system work. The more likely result of a precipitous end to retail price maintenance would be an end to widespread distribution of mutual fund shares, and most Americans would not have an opportunity to consider investing in mutual funds. As a consequence, many mutual funds—which by their nature tend to be self-liquidating and, therefore, require continuous distribution—would be adversely affected." Transmittal Letter at v.

SUMMARY OF ARGUMENT

The Investment Company Act of 1940 was enacted in response to the problems found to exist in the mutual fund industry at that time. The Act was tailored to deal with those problems in the context of the unique characteristics of mutual funds, i.e. the continuous need to distribute new shares to offset the threat of self-liquidation caused by the continuous obligation to redeem outstanding shares. The ability to maintain continuous distribution was adversely affected by the so-called "bootleg" market in mutual fund shares. Operations of the "bootleg", or secondary, market tended to channel mutual fund sales out of the primary distribution system, raising the threat of self-liquidation. (Investment Trust Study at 809, 865).

Congress responded to that danger by enacting § 22 of the Investment Company Act, which regulated every aspect of the distribution system. For over 30 years, Congress, the SEC, and participants in the mutual fund industry have recognized that § 22, and particularly § 22(d), represented a Congressional abandonment of normal antitrust considerations in favor of a rigid, involuntary scheme of retail price maintenance designed to protect the primary distribution system. The system of retail price maintenance was re-enacted without change in 1970.

The pervasive regulatory scheme embodied in § 22 authorizes the SEC, either on its own or through its authority to oversee the NASD, to regulate the distribution system in accordance with Congressional policy. The SEC has continually exercised that authority and has only recently proposed a restructuring of the mutual fund distribution system. The relief sought by Appellant in this case is inconsistent with the SEC proposal. In fact, granting such relief would unquestionably cause "two regimes to collide." (*Pan American World Airways, Inc.* v. *United States*, 371 U.S. 296 (1963)).

In light of the authority granted the SEC pursuant to a Congressional decision to abandon normal competitive requirements, the SEC exercise of that authority, the SEC's expertise in this highly complex area, and the certainty of conflict should the antitrust court intrude, the decision of the court below that "the price maintenance practices complained of are immune from ordinary antitrust strictures" should be affirmed. See *Pan American, supra; Hughes Tool Company* v. *Trans World Airlines, Inc.*, 409 U.S. 363 (1973); *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963); and *Gordon* v. *New York Stock Exchange*, 498 F.2d 1303 (2d Cir. 1974), *cert. granted*, 43 U.S.L.W. 3295 (1974).

The court below also was correct in holding that both the retail price maintenance provisions of § 22(d) and its necessary companion, § 22(f), specifically exempt the activities complained

of from the antitrust laws. A principal purpose of § 22(d) was to protect the primary distribution system from disruptive secondary market competition. It accomplished that purpose by requiring all "dealers"—i.e. persons "regularly engaged in the business" of buying and selling securities for their own account—to comply with § 22(d) and maintain the public offering price in sales of mutual fund shares. This provision eliminated the ability of the secondary market to engage in the cutthroat price competition which jeopardized the primary distribution system prior to 1940, and had the effect of channeling all mutual fund share sales and redemptions into the primary distribution system. Section 22(f), which sanctions restrictions on transferability, was specifically designed to allow continuation of the practice of restricting transferability of fund shares in order to keep sales and redemption of such shares in the primary distribution system.

Appellant's attempt to limit the scope of § 22(d) and § 22(f) to the primary distribution system must be rejected. The result sought by Appellant can be reached only through a completely unjustified, narrow reading of the language of both § 22(d) and § 22(f). It is directly contrary to the Congressional determination that protection of investors in mutual fund shares is best served by preserving the integrity of the primary distribution system at the expense of normal competitive requirements.

ARGUMENT

I.

THE DISTRICT COURT CORRECTLY RULED THAT THE PERVASIVE REGULATORY SCHEME OF THE INVESTMENT COMPANY ACT IMPLIEDLY EXEMPTS THE DISTRIBUTION OF MUTUAL FUND SHARES FROM THE ANTITRUST LAWS AND GRANTS TO THE SEC EXCLUSIVE JURISDICTION OVER THE ALLEGED UNLAWFUL CONDUCT OF APPELLEES.

A. Appellant Misconceives the Standards For Establishing Implied Immunity From The Antitrust Laws

The court below recognized that the antitrust laws are applied to regulated industries with the understanding that Congress, in establishing regulatory patterns, responds to specific problems existing within a particular industry, and that when Congress applies regulatory considerations to those problems it may reject competition in favor of regulation. In this case, Congress, in enacting the Investment Company Act, responded to the specific problem of disruptive secondary market competition with the primary distribution system for mutual fund shares. Such competition was deemed a threat to the industry, which was especially dependent on a strong primary distribution system for new fund shares in order to meet its obligation to redeem outstanding shares without being threatened by self-liquidation. Congress responded by establishing a regulated retail price maintenance system designed to restrict normal competitive influences. In so doing, it impliedly immunized the activities of that distribution system from the antitrust laws and entrusted the governing of those activities to the exclusive jurisdiction of SEC regulation.

This conclusion flows from the type of analysis that this Court traditionally makes in determining whether antitrust immunity is to be inferred from the pattern of industry regulation adopted by the Congress. This analysis consists of three separate

steps. The first step is to determine the Congressional purpose in enacting the regulatory scheme, for it is the duty of the courts to give "hospitable scope" to that purpose. *United States* v. *Hutcheson*, 312 U.S. 219, 235 (1941). Almost every case involving implied immunity deals with that issue. See *Otter Tail Power Co.* v. *United States*, 410 U.S. 366 (1973); *Federal Maritime Commission* v. *Seatrain Lines, Inc.*, 411 U.S. 726 (1973); *Hughes Tool Company* v. *Trans World Airlines, Inc.*, 409 U.S. 363 (1973) and *Pan American World Airways, Inc.* v. *United States*, 371 U.S. 296 (1963).

If it is determined that Congress intended to substitute regulation for competition or to subject normal competitive forces to specific regulatory restrictions, then the scope of that regulatory power must be examined to determine whether a regulatory agency has authority to deal with the activities complained of. See *Hughes, supra*, and *Pan American, supra*. Finally, if the agency has authority to deal with the matter, the antitrust court must determine whether its intervention would create the possibility of conflict with the regulatory agency and undermine the regulatory pattern established by the Congress. See *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963) and *Gordon* v. *New York Stock Exchange*, 498 F.2d 1303 (2d Cir. 1974) *cert. granted* 43 U.S.L.W. 3295 (1974).

Appellant ignores this analysis. Indeed, it does not concede that implied immunity from the antitrust laws is necessarily found when application of those laws to the conduct challenged would create a "basic conflict with the authority of the regulatory agency." (App. Br. at 56). It argues that even where conflict actually exists, implied immunity may be found only if three additional conditions exist. Appellant characterizes these conditions as:

> "(1) the conduct challenged in the antitrust action must be the precise subject of a proceeding subject to the regulatory agency's remedial powers; (2) the regulatory scheme must require the supervising agency to focus

upon competitive considerations in exercising those powers; and (3) the agency must have express statutory authority to immunize the conduct in question from the antitrust laws." App. Br. at 56.

Appellant does not cite any case to support its contention that any one, much less all three, of these conditions, are essential prerequisites for implied immunity. Indeed, no such case exists. Appellant's argument reflects fundamental misconceptions of the way this Court has applied the antitrust laws to regulated industries.

1. Appellant's First Misconception

Appellant's argument that to find antitrust immunity "the conduct challenged in the antitrust action must be the precise subject of a proceeding subject to the regulatory agency's remedial powers" mistakes the facts in one case for the rule to be applied in all cases. For example, in *Hughes, supra,* cited by Appellant, (App. Br. at 56), the issue being litigated—the way in which Toolco had exercised its control over TWA—was in fact the subject of a CAB proceeding, and this Court ruled that an implied immunity did exist. However, this Court did not rule that such a proceeding was a *condition* to finding an implied immunity. On the contrary, the Court ruled:

> "[T]he authority of the Board to grant the power to 'control' and to investigate and alter the manner in which that 'control' is exercised leads us to conclude that this phase of CAB jurisdiction, like the one in the *Pan American* case, pre-empts the antitrust field." 409 U.S. at 385.

Indeed, the Court in *Hughes,* stated that in *Pan American Airways, Inc.* v. *United States* no such proceeding occurred.

> "It should be noted in that connection that in the *Pan American* case, Pan American, which owned 50%

> of the stock of the air carrier Panagra, was charged with using its control to prevent Panagra from receiving the authority of the CAB to extend its route from the Canal Zone to the United States. That restraint was held beyond the reach of the antitrust laws *even though the CAB had taken no action to investigate, let alone, act* on the alleged misfeasance. . . ." 409 U.S. at 385, 386.

The pertinent inquiry, then, is not as to the existence of a "proceeding" but as to *authority.* If action has been taken pursuant to that authority, as in the instant case, the existence of an implied immunity is even clearer.

Clearly, if a regulatory agency lacks authority over a specific practice, it would be impossible to conclude that the antitrust laws were preempted with respect to that practice. Thus, in *Silver, supra,* this Court held that the SEC had no jurisdiction over the allegedly unlawful activities of the Exchange, and therefore normal antitrust strictures were applicable. The opinion in *Silver* suggested, however, that "a different case" would arise if the SEC did have jurisdiction over those activities. (373 U.S. at 358 n. 12).

In *Gordon, supra,* the Court of Appeals for the Second Circuit found the "different case" contemplated by *Silver.* (498 F.2d at 1304). The court held that the SEC had exclusive jurisdiction over the New York Stock Exchange's minimum commission rate structure because the Commission had authority over that structure, i.e. the power to alter or supplement Exchange rules, and was exercising that authority. Here the case is stronger. The Commission has the authority over the practices complained of, is exercising that authority, and in addition, unlike *Gordon,* must act pursuant to a direct statement of Congressional policy drastically limiting competition in the distribution of mutual fund shares through a system of retail price maintenance.

2. Appellant's Second Misconception

Appellant further argues that to find an implied immunity the "regulatory scheme must require the supervising agency to focus upon competitive considerations in exercising those powers." (App. Br. at 56). Appellant ignores, however, the obvious fact that competition is *not* always the Congressional goal in formulating regulatory legislation. In some instances Congress abandons competition for other goals. Thus, a determination of whether a pervasive regulatory scheme implies a limited antitrust immunity depends on whether Congress has favored regulation over competition in the area in question.

The court below recognized that in this case competition was abandoned in favor of another regulatory goal. That goal was protection of the primary distribution system from secondary market competition. Protection was accorded to that system by Congress because it believed that, given the obligation to redeem, continuous sales of new fund shares were essential to the preservation of the mutual fund industry. The importance of protecting that primary system from unfair and destructive secondary market competition is still recognized by the SEC[18] and accordingly, competitive considerations remain subservient to the principal regulatory concerns of the agency.

In bringing this case the Antitrust Division would have served the public interest better had it heeded the admonition of the District of Columbia Circuit Court of Appeals to the FCC in *Hawaiian Telephone Co.* v. *Federal Communications Commission*, 498 F.2d 771 (D. C. Cir. 1974). In that case the court held that the FCC improperly considered competition when it approved telephone service between Hawaii and the mainland. The court stated:

> "The whole theory of licensing and regulation by government agencies is based on the belief that competition

[18] 1974 SEC § 22(d) Report at 105.

cannot be trusted to do the job of regulation in that particular industry which competition does in other sectors of the economy. Without in any way derogating the merits of the competitive free enterprise system in the economy as a whole, we cannot accept the action of the FCC here in a tightly regulated industry, supported by an opinion which does no more than automatically equate the public interest with additional competition." (*Id.* at 777).

3. Appellant's Third Misconception

Finally, Appellant argues that to find exclusive jurisdiction the administrative agency must have express statutory authority to immunize the conduct challenged from the antitrust laws. Appellant cites *United States* v. *Philadelphia National Bank,* 374 U.S. 321 (1963), *Hughes, supra, Pan American, supra,* and *Silver supra,* apparently for this proposition. None of those cases, upon examination, supports that contention. In *Silver,* this Court ruled that the SEC lacked authority over enforcement of the Exchange rules being challenged. In the absence of such authority there could be no immunity, and there was no need to consider whether the SEC's jurisdiction was exclusive. Thus, that case did not turn on the absence of express immunizing power but on the absence of any jurisdiction.

The *Hughes* and *Pan American* cases involved the Federal Aviation Act, which does provide that when certain agreements between carriers are approved by the CAB antitrust immunity attaches. However, the decisions in those cases, finding immunity, did not turn on that point. Rather, they turned on the existence of the authority in the CAB to review the alleged unlawful acts in the context of a regulatory policy that overlapped and conflicted with normal antitrust considerations. The existence of such authority convinced this Court that to impose antitrust strictures on parties subject to the CAB jurisdiction

would result in an intrusion upon and a frustration of the authority of the CAB.

Appellant also misreads this Court's decision in *Philadelphia National Bank*. In that case, the Bank Merger Act did not confer immunizing authority on the Comptroller of the Currency. But this Court's decision that there was no immunity turned not on the absence of such authority, but on a finding that the Federal regulatory pattern over the banking industry reflected a Congressional intent not to preempt the antitrust laws. In fact, the legislative history made clear that Congress intended that no immunity be implied. The Court stated:

> "Nor did Congress, in passing the Bank Merger Act, embrace the view that federal regulation of banking is so comprehensive that enforcement of the antitrust laws would be either unnecessary, in light of the completeness of the regulatory structure, *or disruptive of that structure*. On the contrary, the legislative history of the Act seems clearly to refute any suggestion that applicability of the antitrust laws was to be affected. *Both the House and Senate Committee Reports stated that the Act would not affect in any way the applicability of the antitrust laws to bank acquisitions.*" 374 U.S. at 352.

In each of the cases relied upon by Appellant, this Court's rationale is clear. Antitrust immunity turns upon the existence of administrative authority to deal with the conduct complained of and upon evidence that Congress intended that the administrative authority displace the antitrust courts in dealing with that conduct. Immunity was denied where the administrative authority did not exist, as in *Silver*, and where the authority that was conferred upon the agency was not intended to displace antitrust policy, as in *Philadelphia National Bank*. Immunity was granted where both authority and intent to displace were found, as in *Pan American* and *Hughes*.

This Court's rationale in the cases discussed above has been followed recently by the Court of Appeals for the Second Circuit. In *Gordon* v. *New York Stock Exchange, supra,* at 14, that court distinguished *Silver,* and held that the language and legislative history of § 19(b) (9) of the Exchange Act, giving the SEC power to alter or supplement Exchange rules over the fixing of commission rates, and the sound policy considerations governing securities regulation, demand the conclusion that such authority exempts the fixing of commission rates from the antitrust laws. That case did not turn on the existence of specific immunizing authority. Indeed none existed. Moreover, unlike this case there was no statutory pattern like § 22 which expressed a Congressional policy to directly regulate an entire aspect of industry operations—i.e. distribution of mutual fund shares—in a manner completely repugnant to the antitrust laws. Nevertheless, the court found that the potential for conflict between the pervasive regulatory pattern administered by the SEC and antitrust policy enforced by the courts represented persuasive evidence of a Congressional intent to displace the antitrust laws.

The same result as in *Gordon* has been reached by the only other two lower court cases which have considered whether alleged illegal acts in the pricing of mutual fund shares are exempt from the antitrust laws. In each case the court reached an affirmative decision although express immunizing authority was lacking. Those cases are the decision of the District Court below and *Baum* v. *Investors Diversified Services,* 286 F. Supp. 914 (N.D. Ill. 1968), *aff'd,* 409 F.2d 872 (7th Cir. 1969).

Thus, in no case, including the cases cited by Appellant, has this Court or any other court established a rule requiring the existence of an express statutory immunizing authority as a condition to finding implied immunity. To the contrary, the issue of implied immunity turns on an overall evaluation of the Congressional objectives in fashioning the particular regulatory scheme involved. As suggested by this Court in *Philadelphia*

National Bank, a Congressional objective to pre-empt the antitrust laws can be evidenced by a regulatory scheme so complete as to leave no area untouched by the regulatory process in which the antitrust laws could operate, or by a regulatory scheme structured in such a way that imposition of the antitrust laws would be disruptive of that structure. (*Supra* at 22.) In this case, as in *Pan Am*, *Hughes* and *Gordon*, both conditions are met.

B. Contrary to Appellant's Contention, Congress Clearly Intended to Substitute a Pervasive Regulatory System for the Antitrust Laws in the Limited Area of Mutual Fund Distribution

The court below held that Congress intended to substitute the pervasive regulatory scheme contained in § 22 of the Investment Company Act for normal antitrust prohibitions in the narrow area of distribution and sale of mutual fund shares. In so doing, the court held, Congress immunized the price maintenance practices complained of by Appellant from ordinary antitrust strictures.

In reaching this conclusion the court below was, and this Court in reviewing that decision must be, concerned with one preeminent and overriding issue: what was Congress' purpose in establishing the system that now regulates the distribution of mutual fund shares? That question must be answered, for Congress sets this nation's policy, and it is the duty of the courts to implement that policy even though it may displace the policy in favor of competition decreed in the Sherman Act.

An understanding of Congressional purpose can be obtained by asking the following questions: what problems was Congress seeking to rectify by establishing the regulatory system? In this regard the pre-1940 mechanism by which mutual fund shares were distributed and the problems raised by that mechanism and

recognized by Congress are crucial. How did the SEC, the agency charged with administering the legislative system, perceive its mandate from Congress, and how has it implemented that mandate through the years? Finally, and particularly important in this case, what has Congress perceived in the years subsequent to 1940 as the result of its actions, and what has been its response?

Any objective analysis of the answers to these questions will reveal that *in enacting § 22 of the Investment Company Act, the principal and overriding Congressional purpose was to protect and preserve the viability of the primary distribution system while protecting investors against excessive sales charges through regulatory rather than competitive means.*

1. Appellant Ignores the Clear Congressional Intent To Substitute Regulation For Retail Price Competition In The Distribution Of Mutual Fund Shares

Far from being a "less intrusive scheme more in keeping with free market traditions," as Appellant erroneously asserts, (App. Br. at 55), the Investment Company Act established a policy of pervasive Federal regulation for mutual fund shares. It thus represented a far-reaching departure from "free market traditions." This departure is particularly evident in § 22 of the Act which establishes a retail price maintenance system and allows restrictions on the transferability of mutual fund shares. Both are repugnant to the antitrust laws. As stated by the District Court, in its opinion below:

> "It is obvious from the foregoing outline of marketing procedures that the sale and distribution of mutual fund shares is accomplished through a *retail price maintenance system which is patently repugnant to the free and open competition requirements of the Sherman Act*. This price maintenance scheme, however, does not operate in a

vacuum. Rather, it is expressly immunized from the otherwise applicable antitrust laws by virtue of the provisions of the [Investment Company] Act and the Maloney Act." J.S. App. at 43, 44.

The anticompetitive nature of the regulatory system governing mutual fund distribution has been repeatedly recognized. The former Chairman of the SEC has, in urging Congress to strengthen the power of the Commission and the NASD to prohibit "excessive" sales charges, described the non-competitive nature of mutual fund distribution as follows:

> "Mutual fund sales charges are not determined by normal interplay of free market forces. . . ."
>
> * * *
>
> "Sellers of mutual fund securities have been insulated by Federal law from price competition at the retail level since 1940."[19]

Similarly, Appellant itself has described § 22(d) as "requiring a rigid scheme of price maintenance at the retail level,"[20] and the SEC, in its 1966 study on the mutual fund industry, has reported to Congress:

> "Section 22(d) is an exception to the usual congressional policy, expressed in the antitrust laws, against price fixing."[21]

The decision by Congress in 1940 to govern the mutual fund distribution system by regulation, not by unbridled price compe-

---

[19] *Hearings on S. 1659 Before the Senate Comm. on Banking and Currency,* 90th Cong., 1st Sess. 25, 26 (1967). (Hereinafter referred to as "1967 Senate Hearings").

[20] *Comments of the Department of Justice Before the SEC Mutual Fund Distribution Hearings,* SEC File No. 4-164, Feb. 2, 1973 at 3.

[21] *SEC Report on the Public Policy Implications of Investment Company Growth,* H. R. Rep. No. 2337, 89th Cong., 2d Sess. 218 (1966).

tition, is further evidenced by the restrictions on transferability permitted by § 22(f). That section, as the court below found, is "a necessary companion to" the retail price maintenance provision of § 22(d). (J.S. App. at 56). The SEC has made clear that § 22(f) gives it authority to prohibit the restrictions imposed by the sales agreements complained of by the Appellant and that it intends to use that authority to the fullest extent necessary. (1974 SEC § 22(d) Report).

2. A Principal Purpose of the Regulatory System Is To Protect the Primary Distribution System From Disruption By Secondary Markets

The court below recognized that when Congress enacted § 22 of the Act, it intended to protect the primary distribution system against destructive competition from the secondary markets. The court pointed out that:

> "*It is an economic fact, recognized by Congress, that the two markets — the primary market . . . and a secondary market as urged by the plaintiffs — cannot co-exist and both remain viable*. Having established a resale price maintenance system in the primary distribution system in which ordinary competitive influences cannot operate, Congress has rejected all attempts to foster a secondary market which might operate to the detriment of the primary market." J.S. App. at 46, 47.

This conclusion is supported both by the legislative history of the Act and the language and structure of § 22. The Commission's Investment Trust Study, which prompted enactment of the Investment Company Act, recognized that all of the distinguishing features of open-end investment companies — including the problems and distortions which plagued them — "spring from the distribution and repurchase practices" of these companies. (Investment Trust Study at 799). It noted that "possible liquidation" was a "constant threat" which required mutual funds

to maintain continuous sales programs in order to offset redemptions with new sales. (*Id.* at 807).

Accordingly the Investment Trust Study was specifically concerned with the problems connected with the distribution of mutual fund shares. (See especially, Investment Trust Study, Pt. Three, Chap. III). The Study found that prior to 1940 the public acquired fund shares through a primary distribution system much like the current system. (*Id.* at 809). The pre-1940 primary distribution system, however, was shaped not by federal regulation but by private contracts which fixed the relationships between underwriters and dealers and established sales charges for fund shares. (*Id.* at 809).

In addition to the primary distribution system, the Investment Trust Study described a secondary market in fund shares. It referred to this market as:

> "[t]he whole field of trading in shares of open-end investment companies by dealers and others. Although no definite data are available, it is known, however, that there were active over-the-counter markets for these shares. . . ." *Id.* at 809.

The Study estimated that the dollar volume of such secondary market activity was equal to the total dollar value of shares sold by investment companies through the primary distribution system. (*Ibid*).

The Study referred to the characterization of the secondary market as a "bootleg market" and described it as follows:

> "The so-called 'bootleg market' was the market made by dealers who traded in the shares of open-end investment companies without the authority of the principal distributors for those companies. These dealers would often offer a little more than the published redemption price and ask a little less than the published sales price. In an

> active market, the unauthorized dealer could still get a greater spread than the authorized dealer. A certain amount of protection was received by such operators through their ability to obtain shares from the legitimate distributors if these dealers were short." *Id.* at 865.

The Study concluded with respect to the "bootleg" market that "[s]uch operations *actually had the effect of initiating a small scale price war between retailers and tended generally to disrupt the established offering price." (Ibid).*

The Study also noted that there was "considerable activity by dealers in switching customers from one open-end investment company to another." (*Id.* at 809). It observed that some individual mutual funds made their own attempts to curb the activities of that "bootleg" market, pointing out that:

> "Certain open-end investment companies attempted to overcome this by restricting the negotiability of their shares, providing substantially that the shares could only be sold or tendered for redemption to the open-end investment company." *Id.* at 865.

The Investment Trust Study had found, however, that the funds were dependent on the dealers for distribution of their shares. As a result, the dealers could take advantage of the dependence of the funds on their distribution efforts to create numerous distortion in the funds' activities. As stated in the Study:

> "[A]ny device or practice which would facilitate the task of the dealer might be adopted or encouraged by open-end investment companies in order to assure the continued sale of their securities." *Id.* at 827.

For these reasons, competitive pressures made ineffective the voluntary efforts of individual funds to deal with the abuses of the secondary market. As the Study concluded:

"The dependence of open-end investment companies upon numerous dealers for the distribution of their shares usually discouraged any effort to supervise or restrict the dealers' trading activities." *Id.* at 828.

Congress responded to the problems created by the bootleg market in the enactment of § 22. Nothing is more illustrative of this fact than the testimony of Mr. David Schenker, the Director of the Investment Trust Study and chief spokesman for the SEC during the Congressional hearings which led to the enactment of the Investment Company Act. Testifying on the genesis of § 22(f),[22] Mr. Schenker stated:

> "There are some companies that have a provision in their certificates to the effect that you cannot sell that certificate to anybody else, and the only way you can sell it is to sell it back to the company. That is a technical problem. *It presents a whole problem which they call the bootleg market.* What happens is that dealers keep switching people from one company to another. In order to prevent these switches, some provisions require that you cannot make these switches but must sell the certificate back to the company. That is a big problem; but it seems to me . . . you are taking away a big portion of the owner's right of initiative."[23]

Mr. Schenker went on to say that the regulation of such restrictions on transferability "ought to be a subject of rules and regulations" (*Id.* at 292), and provoked the following exchange with Senator Wagner, the sponsor of the bill:

---

[22]The predecessor of § 22(f) was § 22(d) (2) of the original bill submitted by the SEC.

[23]*Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency,* 76th Cong., 3d Sess. 292 (1940). (Hereinafter referred to as "1940 Senate Hearings").

"Senator WAGNER. You provide rules?

Mr. SCHENKER. That is right.

Senator WAGNER. *You provide rules, I suppose, under which they make application to the Commission with respect to whether they may or not?*

Mr. SCHENKER. *No. If this bill becomes law, and after we study the whole situation, if we feel there are abuses which cannot be corrected except by putting in a restriction on alienability, then we shall formulate rules, after discussing them with the industry.*"[24]

Mr. Schenker's answer to Senator Wagner's last question indicates that Congress and the SEC intended to permit mutual funds to continue using the existing restrictions on transferability absent Commission rules to the contrary. This intention became clearer in the revised bill which emerged from industry–SEC negotiating sessions. Section 22(f) of the revised bill, as enacted, said:

> "No registered open-end company *shall restrict* the transferability or negotiability of any security of which it is the issuer *except in conformity with* the statements with respect thereto contained in its registration statement *nor in contravention* of such rules and regulations as the Commission *may prescribe* in the interest of the holders of all of the outstanding securities of such investment company."

The Senate Committee report on the bill also evidenced the Congressional intention to allow restrictions to be used if no SEC rules prevented them. It stated: "The negotiability of open-end securities may not be restricted in contravention of provisions which *may* be formulated. . . ."[25] The House Committee Report

[24] 1940 Senate Hearings at 293.
[25] S. Rep. No. 1775., 76th Cong., 3d Sess. 16 (1940).

is to the same effect: "Subsection (f) provides that the negotiability or transferability of redeemable securities of open-end companies may not be restricted in contravention of rules and regulations which the Commission *may* prescribe."[26] Thus, the legislative history makes it abundantly clear that Congress enacted § 22(f) with a clear knowledge of the purpose to which restrictions on transferability had been put by the funds and that Congress intended to let them stand absent SEC action to the contrary.

Appellant, understandably in light of the foregoing, has little to say concerning the legislative history of § 22(f). It takes considerable pains however, to attempt to show that the Congressional intent underlying the retail price maintenance provisions of § 22(d) has nothing to do with elimination of secondary market competition. According to Appellant, § 22(d) was merely intended to remedy the problem of "dilution" caused by "insider trading". (App. Br. at 26).

Appellant points out (App. Br. at 29, 30), in support of its argument, that the original SEC sponsored bill would have required "forward pricing" and prohibited "backward pricing" of fund shares. Such forward pricing, according to Appellant, would have eliminated the problem of "dilution" caused by "insider trading". According to Appellant, the forward pricing requirement was opposed by the industry and dropped in the compromise bill in favor of § 22(d). That section, Appellant argues, served the same anti-dilution purpose by requiring "insiders as well as all other investors to pay the full public offering price. . . ." (App. Br. at 31).

Appellant is simply wrong in its reading of the legislative history. The bill as finally enacted dealt with backward pricing as well as with other causes of unfair dilution. It did so, however, not through § 22(d) but through the provisions of §§ 22(a) and 22(c). Those sections, *inter alia,* specifically authorize the NASD (and if the NASD fails to act, the SEC) to adopt rules in

[26] H.R. Rep. No. 2639, 76th Cong., 3d Sess. 20 (1940).

connection with the sale of mutual fund shares "for the purpose of eliminating or reducing sc far as reasonably practical, *any dilution* of the value of other outstanding securities of" an investment company. In fact, the SEC has used its authority under § 22(c) to eliminate the very practice of backward pricing by establishing a forward pricing rule. (Investment Company Act Rule 22c-1, 17 C.F.R. § 270.22c-1).

The SEC's forward pricing rule was not adopted until 1968. However, soon after passage of the Act in 1940, the SEC was granting exemptions from § 22(d) to allow *insiders* to purchase mutual fund shares at no sales load.[27] These exemptions were granted pursuant to § 6(c) which authorizes the Commission to grant an exemption

> "if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title."

Thus, Appellant would ask this Court to believe that even though § 22(d) was passed to solve the problem of dilution caused by "insider trading", as Appellant contends, the SEC immediately exercised its exemptive powers and found it consistent with the purposes fairly intended by § 22(d) to allow that very problem to continue. It then took no further action to deal with the problem until adoption of the forward pricing rule 28 years later.

Moreover, it is incongrous for Appellant to argue that Congress used the familiar anticompetitive device of retail price maintenance to solve the wholly unrelated problems of insider abuse. The fact is that when Congress intended to reach insiders by the Investment Company Act, it did so in a precise way. Thus, Congress defined the term "affiliated person" in § 2(a)(3)

---

[27]See, Investment Company Act Rel. No. 2798 (January 20, 1959), CCH Fed. Sec. L. Rep., Transfer Binder, '57-'61 Decisions, ¶76, 625 at 80, 395.

to broadly encompass all persons who may have an especially advantageous relationship with an investment company. It used the term "affiliated person" throughout the Investment Company Act whenever it intended to deal specifically with problems of insider abuse.[28] But § 22(d) does not use the term "affiliated person"; instead, it speaks of "any person", with only those exceptions specified therein.

Nothing could be more indicative of the effect of § 22(d) in suppressing secondary market competition than the reaction of secondary market dealers. Aisel & Company, a major force in the secondary market, summarized its understanding of § 22(d) as follows:

> "If the provision [§ 22(d)] will achieve anything at all – and we think it was designed for this purpose – it will effectively hamper street dealers in dealing in trust shares, concentrate such transactions in the hands of authorized dealers and principal underwriters, and thus create a virtual monopoly."[29]

3. The SEC Has Direct Regulatory Authority Over the Alleged Unlawful Activities of Appellees and Is Exercising That Authority

Despite attempts to characterize the Commission's authority as merely "supplementary oversight" (App. Br. at 55), Appellant does not dispute the SEC's authority to deal with the precise activities of which it complains. Thus, in the 1973 Mutual Fund Distribution Hearings, Appellant urged the Commission to seek a complete legislative repeal of § 22(d) but argued that the Commission "need not wait for repeal" because it has the power under § 6(c) of the Investment Company Act to eliminate the

[28] See, e.g., § 17 entitled "Transactions of Certain Affiliated Persons and Underwriters," 15 U.S.C. § 80a-17.

[29] Memorandum Covering S. 4108 from Robert White of Aisel & Company to Wallace Fulton, Executive Director of the NASD (August 29, 1940), Joint Appendix at 315.

adverse effects of the resale price maintenance provisions of § 22(d).[30] The Antitrust Division specifically pointed out that § 22(f) could be used to preclude the funds from using restrictive provisions to suppress the secondary market if § 22(d) were repealed. (*Id.* at 13-14).

The 1973 hearings were part of a long-standing SEC regulatory concern over price competition in the distribution of mutual fund shares, including the effect of the restrictions complained of by Appellant. Indeed, the Commission's attention was focused on this issue immediately after passage of the Act. Thus, in the 1941 SEC hearings on proposed NASD Rule 26 dealing with distribution of mutual fund shares, secondary market dealers claimed that certain provisions of the Rule would unjustly discriminate against them by impeding the transfer of fund shares in secondary market transactions and forcing such dealers to assume additional risks. The Commission refused to disapprove those restrictions observing that Congress never intended or expected "a free and open market" for mutual fund shares. As the Commission pointed out, "the nature of [mutual fund] shares and the manner in which they are distributed and redeemed are so extraordinary as perhaps to justify extraordinary treatment."[31]

At least since 1962, regulatory concern with respect to retail price maintenance has been the subject of direct and repeated communications between the Commission and Congress. In 1962, the Commission transmitted to the Congress the so-called Wharton Report[32] which, among other things, examined the effect of the regulatory pattern on the distribution of mutual fund shares. It specifically attributed the absence of retail price com-

---

[30]*Comments of the Department of Justice Before the SEC Mutual Fund Distribution Hearings,* File No. 4-164, Comments of the Antitrust Division dated February 2, 1973 at 2-3.

[31]Exchange Act Release No. 2866 (April 12, 1941); 9 SEC 38, 44-46.

[32] *A Study of Mutual Funds,* Wharton School of Finance and Commerce of the University of Pennsylvania, H.R. Rep. 2274, 87th Cong., 2d Sess. (1962).

petition to the provisions of § 22(d), NASD Rule 26 and the sales agreements of which Appellant now complains. (*Id.* at 31-35).

In 1963, the Commission transmitted to Congress its Special Study of the Securities Markets [33] which discussed in some detail the effect of the restrictions contained in the sales agreements on the secondary market. The Study concluded that the retail price maintenance system created by § 22(d) warranted "further consideration."[34]

In 1966 the Commission reported its "further consideration" to the Congress in a Report on Public Policy Implications of Investment Company Growth.[35] The SEC then advised Congress that it believed the retail price maintenance provisions of § 22(d) to be primarily responsible for "excessive" sales charges for mutual fund shares. The SEC expressly considered and rejected abolition of § 22(d) because of the "unsettling and unforeseeable effects which abolition of retail price maintenance might have on the broker-dealer community,"[36] and because the benefits of price competition were not likely to flow to those most in need of protection – the unsophisticated investor.[37] The SEC recommended instead that the Investment Company Act be amended to place a flat statutory ceiling on sales charges for fund shares.

The Commission's recommendations were thoroughly considered by the Congress over a period of approximately four years prior to enactment of the Investment Company Act Amendments of 1970. Throughout hearings on those amendments, the SEC's position on § 22(d) was repeatedly questioned, and other witnesses urged modification or repeal of these restrictions on

---

[33] *SEC Report on the Special Study of Securities Markets, H.R.* Doc. No. 95, 88th Cong., 1st Sess. (1963). (Hereinafter referred to as "Special Study Report").

[34] *Special Study Report,* Pt. Four at 98.

[35] *Public Policy Report, supra* at n. 21.

[36] *Id.* at 223.

[37] *Id.* at 222.

competition. It is evident from those hearings that Congress was fully aware that § 22(d) represented an exception to the antitrust laws and that the section applied to all broker-dealers.

Thus, in 1967 hearings before a House Subcommittee, then SEC Chairman Manuel F. Cohen engaged in the following dialogue:

> COHEN. The statute now, and since 1940, interferes with competitive business in this area.
>
> MR. WATKINS. Not to the extent you are proposing.
>
> COHEN. I am sorry, sir. The statute is unequivocal. No person, no matter where he got it, from the issuer, from another dealer, or even from a private person, no broker-dealer may sell a share of a particular fund at a price less than that fixed by the issuer.
>
> MR. WATKINS. True.[38]

On the Senate side the same situation prevailed. For example, Senator Proxmire pointed out that the purpose of repealing § 22(d) would be:

> "[t]o permit price competition in the sale of the same mutual fund by various *broker-dealers*."[39]

Senator Mondale explained the effect of § 22(d), saying it "makes it illegal for *agents* to sell at a sales charge less than that prescribed by the company."[40] and later explained that "it does not prohibit or have anything to do with competition as between companies." Professor Paul Samuelson urged Congress to repeal

> "the provision in section 22(d) of the Investment Company Act of 1940 which prohibits a broker from

[38] 1967 House Hearings at 711.
[39] 1967 Senate Hearings at 51, 52.
[40] *Id.* at 769.

selling mutual fund shares to the public at less than the public offering price."[41]

Throughout these hearings the Commission impressed on Congress its concern over the uncertain results of abandonment of the price maintenance provision in § 22(d). Commissioner Owens testified:

> "[W]e were apprehensive that as a regulatory agency we could not tell you gentlemen where a repeal of 22(d) would take us. There was apprehension and there still is, I might add, that we don't know what conditions will result in the marketplace if 22(d) is repealed.
>
> We are told that wildcatting and price-cutting will be ruinous to the industry. It well might be."[42]

The Congress ultimately accepted the Commission's basic approach in the 1970 amendments. It directed the NASD, subject to SEC oversight, to set maximum sales charges and retained § 22(d) without change. The Senate Committee, however, was not satisfied that the consequences of repeal of § 22(d) had been adequately studied. Accordingly, the Committee Report stated:

> "In its deliberations your committee considered the possibility of deleting Section 22(d) from the act. However, impressive testimony was given that there had not been sufficient study of the consequences of such an amendment. Therefore, your committee requests the Securities and Exchange Commission to review the consequences of such a proposal on both the investing public and mutual fund sales organizations and report to it as soon as is reasonably practicable."[43]

---

[41] 1967 Senate Hearings at 348.

[42] *Hearings on S. 34 and S. 296 Before the Senate Comm. on Banking and Currency*, 91st Cong., 1st Sess. at 18 (1969).

[43] S. Rep. No. 184, 91st Cong., 1st Sess. at 8 (1969).

Pursuant to this Congressional request the Commission transmitted to Congress the 1974 SEC § 22(d) Report. In the Report, the Commission again rejected complete abolition of § 22(d), but requested additional legislative authority to abandon § 22(d) administratively should conditions later permit. The SEC accepted the Appellant's argument that its existing statutory authority was adequate to substantially modify the system of retail price maintenance, but it differed sharply with Appellant as to how and to what extent that authority should be exercised.

The proposals announced by the Commission in the 1974 SEC § 22(d) Report graphically demonstrate the fact that the activities complained of in Appellant's Complaint are subject to the direct regulatory authority of the SEC, and that the questions raised by the Complaint are particularly well-suited to resolution by the SEC. Thus, since the likely result of an immediate lifting of the retail price maintenance requirement would be "disruption" of the distribution system, the Commission stated that it

> "has chosen a middle path, intended to reduce or eliminate many of the inequities and inefficiencies of the present fund distribution system while, at the same time, avoiding the dangers of a sudden abolition of retail price maintenance. *We have decided to exercise fully our existing administrative powers to lay the groundwork for the gradual and orderly introduction of retail price competition into the mutual fund distribution system.*" Transmittal Letter at v.

The Commission proposed a broad range of related regulatory changes which would, *inter alia,* allow price competition through brokered secondary market transactions while still

> "prevent[ing] a secondary brokered market from having an adverse impact on the primary distribution system." 1974 SEC § 22(d) Report at 109.

The Commission's Report makes clear that solution of problems and imposition of regulatory changes in the area of mutual fund distribution are best made by the SEC, rather than the antitrust courts. As stated by Chairman Garrett,

> "A regulatory agency seems particularly well-suited to perform the task of adapting the regulatory framework in response to changed conditions. It is the genius of the administrative process that the intent of Congress can be effectuated in a complex and specialized area by an agency which is provided with flexibility and discretion to adjust the law as circumstances demand." Transmittal Letter at vii, viii.

4. The Antitrust Relief Sought by Appellant is Clearly in Conflict With the Investment Company Act and With the Commission's Recent Regulatory Action

Appellant attempts to mask the obvious conflict between antitrust relief and the regulatory scheme for investment companies. It states that the SEC's "recent efforts" to move toward price competition in mutual fund retail sales "show that antitrust principles are in harmony, not in conflict, with the purposes of the Investment Company Act." (App. Br. at 58, 59). Yet, as demonstrated above, the very "recent efforts" to which Appellant points — the recommendations contained in the 1974 SEC § 22(d) Report — are themselves in conflict, not in harmony, with the result sought by Appellant in at least three respects.

First, Appellant seeks elimination of all bars to a secondary dealer market; the SEC disagrees and does not believe that a secondary dealer market should be established at this time. (Transmittal Letter at vii).

Second, Appellant seeks elimination of all restraints on a secondary brokered market; the SEC disagrees and believes that such a market should be permitted only if adequate regulatory provision is made "to help neutralize any adverse impact upon

the funds' primary distribution systems". (1974 SEC § 22(d) Report at 105).

Third, Appellant seeks full price competition now; the SEC disagrees and intends to gradually "move toward the goal of price competition in an orderly manner." (Transmittal Letter at vii).

The Commission's recommendations are premised on its understanding of the dependence of the mutual fund industry on the primary distribution system and its appreciation of the need to protect, in accordance with the Congressional mandate, the integrity of that system. Appellant's argument that there is no conflict between the antitrust laws and the pattern of regulation for the distribution of mutual fund shares, on the other hand, is based on its refusal to accept the existence of this Congressional purpose. This refusal is justified by a series of gross misstatements concerning the regulatory scheme. Appellant states:

> "[Section 22(d)] *permits* resale price maintenance with respect to the issuance and primary distribution of mutual fund shares." App. Br. at 53.

Section 22(d), in fact, *demands* retail price maintenance under threat of criminal sanction. Appellant knows that to be true, as do the Commission,[44] the Congress[45], and the Appellees.

Appellant states:

> "Taken together, these provisions [§ § 22(d), 22(f), 6(c) and 38] establish a scheme of cooperative regulation, in which underwriters, brokers and dealers are free to determine for themselves what is necessary for regulation of the mutual fund distribution network, with the Commission exercising selected supplementary powers of direct regulation and secondary supervision in the interests of the investing public." App. Br. at 54.

* * *

[44] *Supra* at 37.
[45] Ibid.

> "Congress thus rejected a policy of pervasive direct regulation in favor of a less intrusive scheme more in keeping with free market traditions. Within the quality control constraints imposed by the rules of the association, Congress left each fund, underwriter and broker-dealer 'free to determine his own business policy' and gave the Commission power of supplementary oversight." App. Br. at 55.

Appellant is, at the very least, confused. It confuses the provisions of the Maloney Act, relating to industry self-regulation, with the pervasive direct SEC regulation contained in the Investment Company Act.

As Appellant must know, under the Investment Company Act underwriters, brokers and dealers in the area of mutual fund distribution are not "free," among other things, to deny requests for redemption (§ 22(e)), to sell new shares at less than net asset value or at other than the offering price (§§ 22(a), 22(d)), to compute net asset value as they choose (Rule 22c-1), to charge any sales load they choose (§ 22(d)) or to enter into whatever sales agreements they choose (§15(c)). They lack these freedoms because the regulatory scheme decreed by Congress has specifically denied them "free business choice" in the area of mutual fund distribution. Such denial is hardly consistent with Appellant's mistaken conception of a "less intrusive scheme" of regulation more in keeping with "free market traditions." (App. Br. at 55).

5. The SEC Also Has Authority Over the Alleged "Horizontal" Activities of Appellees

As a last-gasp effort to salvage some portion of its case from the detailed opinion of the court below, Appellant argues that Count I of its Complaint contains broad allegations of horizontal conspiracy. Appellant argues, citing *Georgia* v. *Pennsylvania R. R. Co.*, 324 U.S. 439 (1945), that the alleged horizontal

activities of Appellees are unlawful because, like the regulatory scheme in the *Georgia* case, the regulatory scheme here "did not authorize collusive action. . . ." (App. Br. at 63) However, the Court in *Georgia* did not hold that a regulatory statute has to specifically *authorize* horizontal activities in order for them to be immune from the antitrust laws. Rather, it held that collusive ratemaking activities were not immune from the antitrust laws when

> "[t]he type of regulation which Congress chose did not eliminate the emphasis on competition in rate making." 324 U.S. at 458, 459.

Thus, the "type of regulation" upon which the holding in *Georgia* rests, is far different than the regulation under the Investment Company Act in the instant case. Here, Congress unquestionably chose to eliminate the "emphasis on competition" in the retail pricing of an individual fund's shares[46]. Competition is replaced by what Appellant itself has called "a rigid system of retail price maintenance." (See, *supra* at n. 20).

The Court's primary concern in *Georgia* was not whether the regulatory statute "authorizes" horizontal activities but whether the statute subjected those activities to regulation. The Court ruled that no implied immunity existed in *Georgia* because:

> "[Congress] has not placed these combinations under the control and supervision of the Commission. Nor has it empowered the Commission to proceed against such combinations. . . ." 324 U.S. at 456.

Thus, the issue with respect to the alleged horizontal activities is the same as that with respect to the other activities of which Appellant complains: are the activities within the mainstream of the SEC's regulatory authority?

---

[46] It should be emphasized that Appellant does not allege any horizontal activities relating to pricing of the various funds. The alleged "horizontal" activities relate only to intrafund pricing.

The horizontal activities alleged by Appellant consist mainly of the inducement of underwriters "to include restrictive provisions in their sales agreements," the distribution of "misleading information . . . concerning the legality of a brokerage market," and the "suppressing" of secondary-dealer market quotations (Complaint, § 17). As previously noted, Appellant has itself agreed that § 22(f) gives the SEC adequate authority to eliminate "restrictions" in sales agreements. (*supra* at 35). Moreover, the SEC's authority to deal with the distribution of "misleading" information and "suppression" of market quotations under the antifraud provisions of the Federal securities law is beyond question. Indeed, the SEC is expressly authorized to adopt rules to "define, and prescribe means reasonably designed to prevent . . . such quotations as are fictitious." (Exchange Act § 15(c)(2)).

Moreover, the SEC could reach the activities complained of through its far-reaching oversight authority contained in the Malony Act. Under that Act, the SEC may suspend or even revoke the NASD's registration for (a) any violation of the Exchange Act "or any rule or regulation thereunder," (b) "any other activity tending to defeat the purposes of" the Maloney Act or failure "to enforce compliance with its own rules."[47] In addition, the SEC may "remove from office any officer or director" of the NASD who "has willfully abused his authority."[48]

In short, the jurisdiction and authority of the SEC plainly encompasses all of the activities alleged to be unlawful in Count I. The existence of this authority in the SEC and the certainty of conflict between exercise of that authority and intervention by the antitrust courts preempts the application of normal antitrust strictures.

---

[47]15 U.S.C. § 78*o*-1.

[48]15 U.S.C. § 78*o*-3(*l*)(3).

II.

THE DISTRICT COURT CORRECTLY RULED THAT BOTH SECTIONS 22(d) and 22(f) OF THE INVESTMENT COMPANY ACT EXEMPTED THE PRACTICES COMPLAINED OF FROM THE ANTITRUST LAWS.

The court below also held that the retail price maintenance system of § 22(d) and its "necessary companion", § 22(f), created a specific exemption from the antitrust laws for the practices complained of. The court stated:

> "[T]hat Congress designed § § 22(d) and 22(f) to create and protect a primary distribution system which is repugnant to the antitrust laws and did so in complete recognition of the fact that the legislation would frustrate the growth of a free secondary market. That statutory scheme is 'incompatible with the maintenance of [an] antitrust action'. *Silver* v. *New York Stock Exchange*, 373 U.S. 341, 358 (1963)." J. S. App. at 58.

Appellant takes issue with that holding by urging that both § 22(d) and § 22(f) be narrowly construed to allow the secondary market to engage in unrestricted retail price competition with the primary distribution system for mutual fund shares. Appellant's position entirely ignores the interrelationship between the primary distribution system and the secondary market, fails to respect the Congressional intent underlying § 22(d) and § 22(f) to protect the primary distribution system, and is based on a misreading of the plain and unambiguous terms of the statutes.

A. Appellant Ignores the Destructive Impact of Secondary Market Operations

Appellant concedes that the Investment Company Act creates a specific exemption from the antitrust laws for retail price maintenance in mutual fund share distribution. (App. Br. at 20, 21). However, Appellant claims that this exemption was not intended

to protect the primary distribution system against secondary market competition and therefore is not broad enough to encompass the activities of Appellees described in the Complaint.

Appellant's argument is rooted in a basic misconception: it views the primary distribution system and the secondary market as separate and distinct markets which do not interrelate. In Appellant's view, the secondary market "cannot . . . undermine, or even adversely affect, primary distribution." (App. Br. at 20). The court below rejected Appellant's argument and stated:

> "[T]he position of the plaintiffs fails to take into account that the creation and maintenance of a free and open secondary market would be totally inconsistent with and might destroy the primary marketing system that is created by the 1940 Act, and particularly by § 22(d), the repeal of which has several times been urged upon Congress with no success. It is an economic fact, recognized by Congress, that the two markets – the primary market . . . and a secondary market as urged by the plaintiffs—cannot co-exist and both remain viable." J.S. App. at 46.

Appellant disregards these findings. It asserts that if a share is purchased in the secondary market, the primary distribution system, while denied the opportunity to sell that share, receives an offsetting benefit in being relieved of the obligation to redeem the share at that time. (App. Br. at 35, n. 30). However, underwriters and dealers in the primary distribution system are also deprived of the commissions on transactions in the secondary market. These commissions furnish the financing necessary to ensure the continuous distribution efforts of the primary distribution system. Absent such financing the primary distribution system could not effectively provide the liquid assets required by the funds to meet their redemption obligations while avoiding self-liquidation.

This "drying up" effect was clearly identified by the 1974 SEC § 22(d) Report to Congress which stated:

> "[S]ince mutual fund shares are continuously issued, underwriters must bear continuing distribution costs; these costs would be present even if a competitive environment has largely eliminated the need to recruit and train a sales force, since an underwriter would still have to pay for such items as the preparation of prospectuses and advertising. Since an underwriter would receive no spread on shares sold in a secondary market, it would be necessary to provide underwriters with some substitute compensation. Similarly, since contract dealers do share a portion of the sales load with the underwriter, it would be unjust if competing secondary market-makers were not also required to bear certain costs to sustain the mutual fund distribution system and to bear certain burdens in order to assure, even in a price competitive environment, that they do not enjoy an unfair competitive advantage over contract dealers *to the point of drying up fund distribution at the primary level.*" 1974 SEC § 22(d) Report at 119, 120.

The potential danger of the secondary market to the primary distribution system was highlighted by the Report. For this reason, the Commission, while announcing a program of gradual regulatory change which would permit the operation of a secondary "brokered" market for mutual fund shares, emphasized that the program should develop only "in the context of the Commission's total regulatory scheme respecting fund distribution."[49]

[49] 1974 SEC §22(d) Report at 105. The SEC's concern with the potential adverse impact of a secondary market also was reflected in the proposal of the Report to exempt variable annuities from the strictures of §22(d). The Commission pointed out that §22(d) "has little relevance to the marketing of variable annuities" because "the nature of the product precludes the development of a secondary market." Id. at 102.

That regulatory scheme would be designed to protect the primary distribution system from the secondary market. The Report stated that:

> "steps should be taken to prevent a secondary brokered market from having an adverse impact on the primary distribution system. Specifically: (1) a fund should be able to impose a reasonable flat transfer fee; (2) orders should not be filled more than one full business day after they were received; and (3) a fund should be able to obtain an exemption from any rule under Section 22(f) upon a showing of a threat to its distribution system." 1974 SEC § 22(d) Report at 109.

The SEC's concern over unrestrained operations of a secondary market was further demonstrated in its request for legislative action. The 1974 SEC § 22(d) Report stated that the specific purpose of its request was to increase the Commission's existing administrative authority to "prevent a secondary dealer market from injuring funds and their distribution systems." (*Id.* at 121). The Report pointed out that the considerations motivating the request "are similar to those that have underlain historic objections to a secondary market in mutual fund shares." (*Id.* at 120, n. 1). The Report stated:

> "Even in a fully competitive environment, however, the nature of the mutual fund industry will demand that fund underwriters and contract dealers be protected from unfair competition on the part of secondary market-makers." *Id.* at 119.

Appellant also attempts to establish a separation between the primary distribution system and the secondary market through an analogy to second-hand goods. Appellant argues:

> "Section 22(d) was not intended to ensure that a fund would have the maximum market for its newly-issued

> shares, to be sold at the fixed price, any more than state fair trade laws are intended to protect producers from competition from the second-hand market for their goods." App. Br. at 34, 35.

Appellant's effort is disingenuous at best. It ignores the obvious fungibility of shares issued by a particular mutual fund. From the investor's viewpoint, it makes no difference whether he buys Wellington fund shares through the primary distribution system or in the secondary market. The share is the same and represents an identical interest in the fund. However, while secondary market purchasers receive the same merchandise, the primary market loses a sale. This is precisely the result § 22 was designed to prevent.

Appellant supports its thesis that § 22 of the Investment Company Act was not intended to affect the secondary market for mutual fund shares by misreading both § 22(f) and § 22(d). Appellant ignores the admonition of this court in *United States v. Hutcheson,* that "legislation should not be read in a spirit of mutilating narrowness." 312 U.S. 219, 235 (1941). *Hutcheson,* like this case, dealt with an exception to the antitrust laws. The Court admonished those who would interpret legislation to recognize "the importance of giving 'hospitable scope' to Congressional purposes even when meticulous words are lacking." (*Ibid.*). The Court, adopting the statement of Justice Holmes, said:

> "A statute may indicate or require as its justification a change in the policy of the law, although it expresses that change only in the specific cases most likely to occur to the mind. The Legislature has the power to decide what the policy of the law shall be, and if it has intimated its will, however indirectly, that will should be recognized and obeyed. The major premise of the conclusion expressed in a statute, the change of policy that induces the enactment, may not be set out in terms, but it is not an

adequate discharge of duty for courts to say: We see what you are driving at, but you have not said it, and therefore we shall go on as before. *Johnson v. United States,* (CCA (1st), 163 F. 30, 32, 18 LRA, NS, 1194)." *Ibid.*

The court below properly followed the admonition of *Hutcheson,* and took full account of the practical context presented to the Congress when it enacted the Investment Company Act and the necessary impact which the provisions of the Act would have on the distribution system and its environment.

B. Contrary to Appellant's Contention, Section 22(d) Clearly Applies to Secondary Market Transactions

Moreover, in this case the "meticulous words" referred to in *Hutcheson* are not lacking. Section 22(d) clearly provides that no "dealer," no matter whether he acquires shares from the secondary market or through the primary distribution system, may sell to investors at other than the public offering price fixed by the prospectus. Hence, there can be no doubt that § 22(d) was intended by Congress to apply to secondary market transactions.[50]

Appellant contends, however, that § 22(d) "does not apply to transactions in mutual fund shares between investors executed through a broker." (App. Br. at 21). To support this argument,

[50] Appellant's convoluted analysis required to reach its conclusion that retail sales of mutual fund shares by non-contract dealers are in the primary distribution chain is indicative of Appellant's attempt to redefine the distribution system to conform to its preconceived antitrust concepts. Appellant (App. Br. at 7, n. 7) concludes that retail sales by non-contract dealers which, as Appellant admits, must be consummated pursuant to § 22(d) are "in the primary distribution chain." That is patently untrue; the principal distribution system is that system created by the vertical contracts among the funds, underwriters, and contract dealers. Every description of the operations of the primary distribution system—from the Investment Trust Study in 1940 to the Commission's 1974 § 22(d) Report—makes this indisputably clear.

Appellant relies on that fact that § 22(d) does not use the term "broker." Appellant argues that since Congress separately defined the terms "broker" and "dealer," it would be inappropriate to read the word "broker" into § 22(d).

Wellington does not contend that the term "broker" should be read into § 22(d). Section 22(d) only refers to "dealers," "underwriters," and "issuers." Wellington does contend, however, that the retail sellers of mutual fund shares in the primary distribution system are plainly included in the statutory definition of "dealer" in § 22(d). The statutory definition of a "dealer" is clearly and unambiguously stated in § 2(a)(11). "Dealer" means *"any person regularly engaged in the business of buying and selling securities for his own account."* Appellant disregards the phrase "regularly engaged in the business of" in that definition. It interprets the terms "dealer" as if Congress had defined it in a "transactional sense" because "parties involved in securities transactions act in different capacities at different times." (App. Br. at 23).

However, § 2(a)(11) makes clear that Congress did not define the term "dealer" in a transactional sense. Under the § 2(a)(11) definition, a "dealer" cannot evade the prohibitions of § 22(d) and sell fund shares at less than the public offering price simply by choosing to *act* as a "broker" in a particular transaction. To construe § 22(d) to give sellers of fund shares such unbridled discretion would be entirely inconsistent with Appellant's characterization of § 22(d) as a rigid scheme of retail price maintenance. (*Supra* at 26).

Appellant cites no reason why, for purposes of § 22(d), the term "dealer" should not mean what Congress plainly said it meant in § 2(a)(11). As Appellant points out, Congress used the terms "broker" and "dealer" in a precise fashion, depending on what it wanted to accomplish. (App. Br. at 22, n. 17). That same Congressional precision demonstrates that when Congress intended to use the term "broker" or "dealer" in a transactional sense, rather than in a status sense, it knew how to do so. Thus,

in § 17(e)(2) Congress stated with respect to brokerage transactions executed by affiliated persons of a registered investment company:

> "It shall be unlawful for any affiliated person of a registered investment company, or any affiliated person of such person—
>
> (2) *acting as broker* in connection with the sale of securities to or by such registered investment company or any controlled company thereof, to receive from any source a commission, fee, or other remuneration for effecting such transaction which exceeds [the limitations set forth in that section.]"[51]

In contrast, § 22(d) does not refer to persons "acting as a broker" or "acting as a dealer." It uses only the term "dealer." And there is nothing in the language of the Act, the context of the distribution system in existence at the time the Act was passed, or the legislative history of the Act which suggests that Congress intended the term "dealer" in § 22(d) to have any meaning other than that specified in § 2(a)(11). Accordingly, all dealers regularly engaged in the business of selling shares to the public are "dealers" as defined in the Act for purposes of § 22(d), and even absent the sales contracts, they could not, through the label of "brokerage transaction," sell mutual fund shares to the public at less than the public offering price.

C. Appellant's Reliance on So-called "Long-standing SEC Interpretations" Is Misplaced

To support its contention that a dealer may evade the prohibitions of § 22(d) simply by choosing to label a particular transaction as a "brokerage transaction," Appellant relies on what it characterizes as a "long-standing SEC interpretation of § 22(d)." However, from thirty-four years of SEC administration of the

[51] See also, the language in §§ 17(a) and 17(d), ("acting as principal"); § 17(e)(1), ("acting as agent"); § 2(a)(8) and 2(a)(17), ("acting in his capacity as such").

Investment Company Act, Appellant is able to present only five items as evidence of this "long-standing interpretation."

Each of these items suffers from the infirmity of Appellant's own argument: none attempts to reconcile itself with the clear and unambiguous meaning of the word "dealer" in § 2(a)(11). None even mentions § 2(a)(11). Thus, the significance of Appellant's five items of evidence is subject to serious question.

Appellant places primary reliance on a 1941 opinion of the SEC's General Counsel[52] which, in response to a hypothetical question states: "In my opinion, the term 'dealer' as used in section 22(d), refers to the capacity in which a broker-dealer is acting in a particular transaction." The opinion provides no rationale for that conclusion. It neither refers to the statutory definition of "dealer" in § 2(a)(11), nor gives any clue as to why that term, as used in § 22(d), should have any different meaning in that section than in the rest of the Act. Plaintiff also relies on *In the Matter of Oxford Company*, 21 S.E.C. 681 (1946). There the Commission revoked the registration of a two-man broker-dealer firm for engaging in grossly fraudulent practices in connection with the accounts of two elderly ladies. In discussing those activities the Commission adopted the rationale of the 1940 General Counsel's opinion referred to above. However, the Commission did not consider whether, much less make a finding that, the broker was "regularly engaged in the business of buying and selling securities for his own account" and was thus a "dealer" as defined by § 2(a)(11).

Appellant's other items of evidence[53] offer no more analysis than the two cited above and are little other than reiterations of the unsupported statements noted above. Indeed, even the Commission's most recent pronouncement in its Report on § 22(d) provides no analysis of the definition of "dealer." The Report merely stated that:

[52] Investment Company Act Rel. No. 87 (March 14, 1941), 3 CCH Fed. Sec. L. Rep. ¶48,774.

[53] *Mutual Funds Advisory, Inc.*, Investment Company Act Release No. 6932 (Jan. 12, 1972); *Opinion of Chief Counsel*, SEC Division of Investment Mgmt. Reg. (April 24, 1973), see Joint Appendix at 246, 247.

> "The Commission and its staff *have consistently taken the position* that Section 22(d) is inapplicable where an individual fund shareholder sells his shares through a broker to another person." 1974 SEC § 22(d) Report at 104.

The Report does not offer any explanations as to *why* or *on what basis* the Commission and its staff have "consistently" taken that position. The conclusion of that Report, however, perhaps provides a clue. There, the Commission made it clear that it does not now view a limited secondary brokerage market with prescribed safeguards, as a threat to the primary distribution system.

But, as the court below noted with respect to the earlier Commission pronouncements, the Report, even as so interpreted, does "not address the problem of likely discrimination between similarly situated investors." (J.S. App. at 67-68, n.61).[54] The court pointed out that the prevention of price discrimination is a "corollary" to the "price maintenance purpose of § 22(d)." The Commission itself has repeatedly recognized that the prevention of price discrimination among similarly situated investors is a principal purpose of § 22(d). See, *In the Matter of Investors Diversified Services*, 39 S.E.C. 680 (1960) where the Commission stated:

> "The purposes of the Section § 22(d) are to prevent discrimination among purchasers and to provide for orderly distribution of such shares by preventing their sale at a price less than that fixed in the prospectus."[55]

---

[54] In the 1974 SEC § 22(d) Report, the Staff attempts to rationalize Commission decisions relating to discrimination with their position on the definition of "dealer." As pointed out below, however, even such interpretations cannot overcome the plain meaning of the statute.

[55] *In the Matter of Variable Annuity Life Insurance Company of America*, Investment Company Act Release Nos. 2974 and 2975, February 25, 1960; CCH Fed. Sec. L. Rep., Transfer Binder '57-'61 Decisions, ¶76,688; *In the Matter of Mid-America Mutual Fund, Inc.*, Investment Company Act Release No. 3612, January 11, 1963; CCH Fed. Sec. L. Rep., Transfer Binder '61-'64 Decisions, ¶76,894.

Indeed, the concern over such price discrimination was a principal reason why the Commission chose sales load limitations rather than the elimination of § 22(d) to deal with the problem of "excessive sales charges" in its recommendations to Congress that preceded enactment of the 1970 amendments to the Investment Company Act.[56]

Under these circumstances, the so-called long-standing interpretation of the SEC is not sufficient to permit Appellant or this Court to disregard the clear and unambiguous terms of § 2(a)(11). Indeed, this Court has made clear that even a contemporaneous administrative construction of a statute "is only one input in the interpretational equation." (*Zuber* v. *Allen,* 396 U.S. 168, 1[illegible] (1969)). Such administrative construction does not permit a court to "abdicate its ultimate responsibility to construct the language employed by Congress." *Id.* at 193.[57]

In *Zuber,* the Supreme Court outlined the essential requirements supporting an administrative construction of statutory language that must be found before that construction can be accorded great weight by the courts. These requirements are: (a) that the administrative construction was made known to the Congress either in drafting the initial legislation or in its reenactment; (b) that there be no evidence that Congress differed with the administrator; and (c) that there be evidence that the administrative construction "enhances the general purposes and policies underlying the legislation." (396 U.S. at 192, 193). Only if these requirements are satisfied should the courts "re-

---

[56] *Supra* at 36.

[57] In the present case the definition of "dealer" as set forth in § 2(a) (11) leaves nothing to construction. "The meaning of a statute, clear and unambiguous on its face, may not be varied by administrative decisions." (*Verbeem* v. *United States,* 154 F. Supp. 431, 434 (E.D. Mich. 1957)), *Aff'd, sub nom., Amlin* v. *Verbeem,* 356 U.S. 676 (1958)). As the Supreme Court has stated in *Norwegian Nitrogen Products Co.* v. *United States,* 288 U.S. 294, 315 (1933):

> "[A]dministrative practice *does not* avail to overcome a statute so plain in its commands as to leave nothing for construction. . . ."

solve any *ambiguity* in favor of the administrative construction . . . ." (*Id.* at 192).

In this case, the clear and unambiguous languge of § 2(a)(11) leaves nothing to "resolve in favor of administrative construction." There is absolutely no evidence that Congress knew of the SEC interpretation in 1940 or when § 22(d) was re-enacted without change in 1970. In fact, the evidence is to the contrary. The legislative history of the 1970 Amendments (*supra* at 37-38) indicates clearly that all participants in those hearings, whether from the industry, the SEC, or the Congress itself, believed that the retail price maintenance provisions of § 22(d) were all pervasive. No one believed they could be circumvented by the simple device of a dealer's decision to execute a particular transaction as a broker.

As was the case in *Zuber*, the alleged administrative construction relied on by Appellant does not contribute to the "broad general purpose" of § 22. Indeed, it would only undermine the rigid retail price maintenance that Congress has mandated in the sale of mutual fund shares and permit the very practices which Congress sought to eliminate.

That the SEC has now determined that a secondary brokerage market, properly regulated and with significant safeguards, will not pose a threat to the primary distribution system cannot alter the fact that in 1940 Congress viewed all secondary market competition as potentially disruptive. Accordingly, the conduct of Appellees in inhibiting that competition, as authorized by the statute and in accordance with its purposes, cannot now be transformed into antitrust violations of 34 years duration.

D. Congress Intended Section 22(f) to Authorize the Restrictions Complained of by Appellant

Although Appellant contends that this Court should accept the SEC's administrative interpretation of § 22(d), it urges the Court to ignore the SEC's interpretation that § 22(f) extends to the alleged unlawful restrictions complained of here. Indeed, Ap-

pellant would even have this Court ignore Appellant's own argument to the Commission in 1973 that § 22(f) grants the SEC adequate authority to outlaw such restrictions.

Appellant thus argues that Appellees' alleged restrictive agreements are not "of the sort" covered by § 22(f). Appellant reaches this conclusion by simply characterizing the agreements as restraints on "the distribution mechanism" rather than restraints on "fund shares" within the scope of § 22(f). Appellant's argument flies in the face of the broad language of § 22(f) which permits a mutual fund to "restrict the transferability or negotiability" of its securities, if the restrictions are disclosed in the fund's registration statement and do not contravene "such rules and regulations as the Commission may prescribe in the interest of the holders of all of the outstanding securities of such investment compan[ies]."

Appellant's attempt to artifically limit the reach of § 22(f) disregards the legislative history of that section (*supra* at 27-32). That history makes clear that § 22(f) was designed to give the SEC regulatory authority to limit the use of restrictions on transferability used by mutual funds prior to 1940 to combat what the SEC spokesman had characterized as the "big problem" of switching posed by the "bootleg" market. The provision initially proposed by the SEC merely would have authorized the SEC to prohibit such restrictions. The provisions of § 22(f), as finally enacted, went further and sanctioned such restrictions unless the SEC, in its discretion, determined otherwise by rule or regulation. The restrictions disclosed to Congress in 1940 which prompted the enactment of § 22(f) were as much restrictions on "the distribution system" then in effect as are the restrictions complained of in this case. They had one purpose—to restrict the transfer of fund shares outside the vertical primary distribution system.

Finally, and perhaps most importantly, since passage of the Act the SEC has been fully aware of the contractual restrictions here complained of, has attributed the nature of the primary distribution system as it now exists in part to the contracts in

which those restrictions are contained, and has acknowledged that such restrictions are authorized by § 22(f).

CONCLUSION

For the reasons stated above the decision of the District Court for the District of Columbia should be affirmed.

Respectfully submitted,

ROBERT E. JENSEN
Williams & Jensen, P.C.
1130 17th St. N.W.
Washington, D. C. 20036

RICHARD M. PHILLIPS
ROBERT A. WITTIE
Hill, Christopher & Phillips. P.C.
2000 L St. N.W.
Washington, D.C. 20036
Attorneys for Appellees
Wellington Management Company and
Wellington Fund, Inc.

January, 1975

APPENDIX

Pertinent Provisions of the Investment Company Act of 1940, 15 U.S.C. § 80a-1, et. seq.

SEC. 2. (a) When used in this title, unless the context otherwise requires—

(11) "Dealer" means any person regularly engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting, or trading in securities, or in owning or holding securities, for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business.

SEC. 6. (c) The Commission, by rules and regulations upon its own motion, or by order upon application, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities or transactions, from any provision or provisions of this title or of any rule or regulation thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title.

SEC. 22. (a) A securities association registered under section 15A of the Securities Exchange Act of 1934 may prescribe, by rules adopted and in effect in accordance with said section and subject to all provisions of said section applicable to the rules of such an association—

(1) a method or methods for computing the minimum price at which a member thereof may purchase from any investment company any redeemable security issued by such company and the maximum price at which a member may

sell to such company any redeemable security issued by it or which he may receive for such security upon redemption, so that the price in each case will bear such relation to the current net asset value of such security computed as of such time as the rules may prescribe; and

(2) a minimum period of time which must elapse after the sale or issue of such security before any resale to such company by a member or its redemption upon surrender by a member;

in each case for the purpose of eliminating or reducing so far as reasonably practicable any dilution of the value of other outstanding securities of such company or any other result of such purchase, redemption, or sale which is unfair to holders of such other outstanding securities; and said rules may prohibit the members of the association from purchasing, selling, or surrendering for redemption any such redeemable securities in contravention of said rules.

(b)(1) Such a securities association may also, by rules adopted and in effect in accordance with said section 15A, and notwithstanding the provisions of subsection (b)(8) thereof but subject to all other provisions of said section applicable to the rules of such an association, prohibit its members from purchasing, in connection with a primary distribution of redeemable securities of which any registered investment company is the issuer, any such security from the issuer or from any principal underwriter except at a price equal to the price at which such security is then offered to the public less a commission, discount, or spread which is computed in conformity with a method or methods, and within such limitations as to the relation thereof to said public offering price, as such rules may prescribe in order that the price at which such security is offered or sold to the public shall not include an excessive sales load but shall allow for reasonable compensation for sales personnel, broker-dealers,

and underwriters, and for reasonable sales loads to investors. The Commission shall on application or otherwise, if it appears that smaller companies are subject to relatively higher operaing costs, make due allowance therefor by granting any such company or class of companies appropriate qualified exemptions from the provisions of this section.

(b)(2) At any time after the expiration of eighteen months from the date of enactment of the Investment Company Amendments Act of 1970, or after a securities association has adopted rules as contemplated by this subsection, the Commission may make such rules and regulations pursuant to section 15(b)(10) of the Securities Exchange Act of 1934 as are appropriate to effectuate the purpose of this subsection with respect to sales of shares of a registered investment company by broker-dealers subject to regulation under section 15(b)(8) of that Act: *Provided,* That the underwriter of such shares may file with the Commission at any time a notice of election to comply with the rules prescribed pursuant to this subsection by a national securities association specified in such notice, and thereafter the sales load shall not exceed that prescribed by such rules of such association, and the rules of the Commission as hereinabove authorized shall thereafter be inapplicable to such sales.

(b)(3) At any time after the expiration of eighteen months from the date of enactment of the Investment Company Amendments Act of 1970, (or, if earlier, after a securities association has adopted for purposes of paragraph (1) any rule respecting excessive sales loads) the Commission may alter or supplement the rules of any securities association as may be necessary to effectuate the purposes of this subsection in the manner provided by section 15A(k)(2) of the Securities Exchange Act of 1934.

(b)(4) If any provision of this subsection is in conflict with any provision of any law of the United States in effect on the date this subsection takes effect, the provisions of this subsection shall prevail.

(c) The Commission may make rules and regulations applicable to registered investment companies and to principal underwriters of, and dealers in, the redeemable securities of any registered investment company, whether or not members of any registered securities association, to the same extent, covering the same subject matter and for the accomplishment of the same ends as are prescribed in subsection (a) of this section in respect of the rules which may be made by a registered securities association governing its members. Any rules and regulations so made by the Commission, to the extent that they may be inconsistent with the rules of any such association, shall so long as they remain in force supersede the rules of the association and be binding upon its members as well as all other underwriters and dealers to whom they may be applicable.

(d) No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter or the issuer, except at a current public offering price described in the prospectus. Nothing in this subsection shall prevent a sale made (i) pursuant to an offer of exchange permitted by section 11 including any offer made pursuant to section 11 (b); (ii) pursuant to an offer made solely to all registered holders of the securities, or of a particular class or series of securities issued by the company proportionate to their holdings or proportionate to any cash distribution made to them by the company (subject to appropriate qualifications designed solely to avoid issuance of fractional securities); or (iii) in accordance with rules and regulations of the Commission made pursuant to subsection (b) of section 12.

(e) No registered investment company shall suspend the right of redemption or postpone the date of payment or satis-

faction upon redemption of any redeemable security in accordance with its terms for more than seven days after the tender of such security to the company or its agent designated for that purpose for redemption except—

(e)(1) for any period (A) during which the New York Stock Exchange is closed other than customary week-end and holiday closings or (B) during which trading on the New York Stock Exchange is restricted;

(e)(2) for any period during which an emergency exists as a result of which (A) disposal by the company of securities owned by it is not reasonably practicable or (B) it is not reasonably practicable for such company fairly to determine the value of its net assets; or

(e)(3) for such other periods as the Commission may by order permit for the protection of security holders of the company.

The Commission shall by rules and regulations determine the conditions under which (i) trading shall be deemed to be restricted and (ii) an emergency shall be deemed to exist within the meaning of this subsection. Any company which, as of March 15, 1940, was required by provision of its charter, certificate of incorporation, articles of association, or trust indenture, or of a bylaw or regulation duly adopted thereunder, to postpone the date of payment or satisfaction upon redemption of redeemable securities issued by it, shall be exempt from the requirements of this subsection; but such exemption shall terminate upon the expiration of one year from the effective date of this title, or upon the repeal or amendment of such provisions, or upon the sale by such company after March 15, 1940, of any security (other than short-term paper) of which it is the issuer, whichever first occurs.

(f) No registered open-end company shall restrict the tranferability or negotiability of any security of which it is the issuer

except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interest of the holders of all of the outstanding securities of such investment company.

(g) No registered open-end company shall issue any of its securities (1) for services; or (2) for property other than cash or securities (including securities of which such registered company is the issuer), except as a dividend or distribution to its security holders or in connection with a reorganization.